ized on an office level throughout the nation, but after the 4600 accounts, which make up the base that pays 65 percent of the tax, to this priority group of accounts we've gone back to various publications which list the larger taxpayers in the nation. We've used lists such as Fortunate [sic] 500, the Texas business—top 400 businesses in Texas. We've looked at the lists put out by (p. 272) *Inc. Magazine*, and we have increased our priority group to the larger taxpayers who may not be paying a lot of tax to the State of Texas but have the potential to pay a tax to us, and we have included those as priority accounts and upped the grouping to around 56 to 5700 accounts.

Q. Okay, sir, and these are audits of persons that are already permitted; is that correct?

A. That's correct.

Q. And do you have any jurisdiction over persons that are not permitted?

A. If I could go back and clarify one point?

Q. Sure.

A. Some of the accounts that we look at within the Fortune 500 group or the—the Texas 400 would be—pardon me—may be permitted for sales tax or may not, depending on what they do, and some of the Fortune 500 companies fall in that same line. Most of these accounts do hold a Texas sales tax permit.

Q. Okay, sir, and if you find a situation—let's say, you're going through an audit—a taxpayer's records and you find (p. 273) records of a vendor—that somebody

had sold that taxpayer something that's an out of state name, what would you do with that name?

A. If we see the seller has not collected the tax, we could go back to our computer system, run his name, find out if he does hold a Texas permit. If he does not hold a Texas permit, we'll try to establish in the audit whether or not the seller called upon the purchaser with a salesman, whether the purchaser found out about the item he was buying through a publication catalog or whatever. We would look at some shipping documents to see where the item that the purchaser was buying—where it was shipped from to see if the seller had inventory in Texas or if it came from a third party source or it came from an out of state location. We would do this—we rely very much on our audit staff for leads in this area because of the amount of sales in the State of Texas. From there if we can see that there may be a good case for us to say that this company is doing business in the State of Texas, we will then go and try to audit this company and assess tax against all of the other sales we've made in the (p. 274) State of Texas. On that particular sale that we've looked at, we will assess it against the purchaser.

Q. Okay, sir. Now, does the Comptroller's Audit Division have a method of scoring accounts to decide whether or not they might have a high incidence of non-compliance?

A. Yes, we have one of the few scoring systems in the nation to score accounts. It's a regression formula—not qualified statistically to speak total about it, but it takes into account various factors and scores the accounts with the highest probability where we can assess tax.

Q. Okay, sir, and this again is the accounts that are permitted; right?

A. Yes, sir.

Q. Okay. Now, if you—do you receive leads from the Enforcement Division, with respect to accounts that might need auditing or that have been just set up for business and that might need auditing as to prior business?

A. Yes, sir, we receive some leads from our Enforcement Division. They are out and about working on various accounts. They may (p. 275) touch ten to 15 or 20 accounts in a day, and they account for some of our leads, and our auditors—they also account for many of our leads. We may come across a Texas based company as we're auditing someone where we can—where we question why the tax was charged or was not charged.

Q. Okay, sir, and do you check or cross check your auditing records against the records of any other agencies or publications to determine whether or not there might be other people out there that need audited?

A. We use various lists that are provided to us. We use FAA records to find out people who have purchased aircraft. The main thing we're looking there are people purchasing aircraft from out of state sellers so that we can go against them for the use tax. We look at our risks, information. We have data tapes that we are comparing to the files we have in Austin to see if we can come up with unpermitted businesses. We have used Dodge reports, which give us indications of building that's going on in Texas, who is doing the building, what contractor, what company it's being built for. (p. 276) We also moni-

tor trade magazines and publications to watch for people coming into Texas building so that we can assess one sales tax against them on any purchases they make and also to hold them liable for corporate franchise tax, if they are incorporated.

MR. MENDEZ: If I may, Your Honor, before I ask the next question, we had requested that our other witness come over here right now in anticipation of putting him on, but we received notice through Mr. Anderson that he is on his way to the American-Statesman for Mr. Bullock to do some announcement, and so he can't be with us this afternoon. Is there any way we could, after this witness then, continue until in the morning to put him on?

M. GEORGE: What is he going to testify to? Maybe I can stipulate to it.

MR. MENDEZ: Well, he's going to testify as to the amount of money that was set up in the—that was estimated to be generated by the 1984 tax bill and as to what his estimate was with respect to the repeal of the magazine subscription law.

(p. 277) MR. GEORGE: We have that in his deposition.

MR. MENDEZ: I haven't—well, that was your questioning of him, and I'll look through there and see what's available—

THE COURT: —who questioned him. If it's evidence, you can offer it.

MR. MENDEZ: Well, we'd have to look through it. If my co-counsel might go through that deposition, it might be possible to use Mr. George's testimony.

MR. GEORGE: The exhibit that is in his deposition that says what he thought will be collected I'll stipulate is admissible without reading anything or having any witness or anything else.

MR. MENDEZ: Well, I don't know if you asked the right questions, Mr. George, is what I'm asking but I'm going to have—

THE COURT: Counsel, you look it over, and maybe you get it in that way, or you don't get it at all. Now—

MR. MENDEZ: Okay. I appreciate it, Your Honor. We haven't (p. 278) subpoenaed him. So he's—okay.

QUESTIONS BY MR. MENDEZ:

Q. Mr. Lee, I notice from your discussion of these programs that you concentrated on businesses. Could you tell the Court why you're looking at those accounts when you cross check them with these other lists?

A. Well, the main drive of the Audit Division is to maximize the revenue into the State of Texas, and all of the things that we do in our audit select program is to bring in additional dollars with the resources that are provided to us. We have a budget of 29 million dollars out of our agency appropriation from the Legislature, and we're trying—we try to bring in the most revenue with the resources that are provided to us as we can.

Q. Okay, sir. If you—would you need additional auditors—let's say, that hypothetically there's you know, another—let's say, there were five million households in the State of Texas that all of a sudden got permits for remitting their use taxes and that you were required to

develop an audit program to check for compliance. Do you think that you (p. 279) might have to add more auditors in order to audit five million new accounts?

A. I believe the best way to explain is that this year or last year we will do somewhere around 12,000 or 13,000 sales tax audits, which is our portion of the total audits we will do in the fiscal year. There are in excess of 450,000 permitted sales tax taxpayers in Texas. We're doing about two percent of those people right now with 525 auditors. To get a hundred percent compliance of just the permitted people, we can do about ten percent on a four-year cycle now at two, two and a half percent a year. So you can from that, you know, cover just the 450,000-plus sales taxpayers. Then if you add the entire population of Texas, you can think about how many people we would have to have.

Q. Okay, sir. So in your opinion it would be a rather awkward task for your division to add in these types—this many auditors?

A. It would be an awkward task to have that many auditors and a losing money proposition on top of it.

Q. What is your budget on a yearly basis again?

(p. 280) A. Just in excess of 29 million dollars. It costs us about $50,000 a year per auditor.

Q. Okay, and do you have an idea—when you send an auditor out and you know he's going to spend an hour at a specific location, do you have an idea or an expectation as to how much money that person is going to generate from being at that location?

A. We have average—we maintain an average dollar figure that we recoup each year that runs somewhere in the range of $400 an hour, or it has in the last couple of years. The auditor may recoup $10, or he may recoup a thousand dollars. If he sees that he's recouping $10, he is behooved to move on to other areas.

Q. Okay, sir. Now, do you hire trained accountants or persons with degrees?

A. Our personnel are recruited from the colleges and universities in Texas and around the metropolitan areas where we have out of state offices. These people are required to have a degree in accounting, and from there we hire them and take them through our own training courses.

(p. 281) Q. Okay, sir, and about how long would it be before an auditor was out on his own and doing his own audits in the Comptroller's office?

A. An auditor would be out doing his own audits within six months from the date he's hired. He will not be the most productive person we have on board because through our—within our training porgram during the first six months they will receive four weeks of classroom type training and then work on smaller accounts during that first six months. After that first six months, they will continue to work on smaller accounts and get experience. Then progressively receive larger accounts as they receive—obtain more experience and additional training.

Q. Okay, sir, and are publishers of magazines that have permits part of the group of companies that you've audited or are auditing under the programs that you have in place now?

A. Yes, sir.

Q. Okay, and could you give the Court an idea of how many audits of people in the SIC code that belong to publishers have been audited in the recent—well, let's say, in the last (p. 282) five years?

A. I looked at some figures from 1982 forward, and taking the entire group of people that fall under printers, publishers and the like, there have been 1200 audits completed, and there's about 200 audits currently in the inventory. I broke the list down to publishers of periodicals, books and one other group I can't remember, and there has been in the last four years approximately a hundred and ninety audits completed, and there's 40 of those in inventory right now.

Q. Okay, sir, and has *Texas Monthly* been audited for its sales tax?

A. Yes, *Texas Monthly* has been audited.

Q. Okay, and have you received—

MR. MENDEZ: Well, let's do this first: I'm going to have this document marked as Defendants' Exhibit No. 17.

(At this time an instrument was marked as Defendants' Exhibit No. 17 for identification.)

QUESTIONS BY MR. MENDEZ:

Q. Sir, I hand you what has been marked as Defendants' Exhibit No. 17. Is that an (p. 283) interoffice memo that is part of the records of your Audit Division?

A. It's an interoffice memo from our agency. Where in our records, I—it was through one of our previous audit managers.

Q. And is that the type of—well, who was it written by, and who was it written to?

A. It was written by Tom Headner, attorney for field operations, [to] [sic] Jerry Layman, manager of out of state audit group.

Q. Okay, and is out of state audit one of the sections of the Audit Division?

A. It was in a different format but it was in—when this memo was written, but it is part of our program, separately budgeted and accounted for.

Q. To put it in perspective, what's the date of the memo?

A. January 5th, 1977.

Q. Okay, sir, and were you in the Audit Division in 1977?

A. I was in the Audit Division in 1977. Part of the year I was in auditor training, and the latter part of the year I was the manager of our Austin audit office.

(p. 284) Q. Okay, and in the course of being in training, would you have been apprised of these type of policy matters that are discussed in this document?

A. I was generally apprised of policy matters. I don't remember this one right offhand.

Q. Would it have been the type of document that would have crossed your desk in training?

A. Possibly.

Q. You're not real familiar with that document; right?

A. No.

MR. MENDEZ: Okay. Well, I'm not going to introduce it. I didn't know if he knew about it or not.

QUESTIONS BY MR. MENDEZ:

Q. Now, sir, have you received any instruction from your superiors? Well, who is the head of your—who is the Deputy Comptroller in charge of field operations?

A. The Deputy Comptroller for Audit Division is Dan Pearson.

Q. And have you received any (p. 285) instruction from Mr. Pearson as to the treatment of out of state magazine publishers with respect to the sales and use tax?

A. We're not going to treat them any differently than we do any other business selling into Texas.

Q. Okay, sir. So you haven't received any specific instruction to eliminate them from the base or include them in the base in a certain manner?

A. No, sir, there's permitted publishers on our index.

Q. Okay, sir, and now if you were doing an audit of some other taxpayer and you ran across a situation where they had bought a magazine from an out of state company, would that be—would that vendor be checked out—that out of state vendor be checked out for a permit for doing business in Texas?

A. We would assess a tax against the purchaser, and we can check to see if the magazine distributor is doing—is showing any reported taxable sales in Texas.

Q. Is it the policy of the—well, does the Audit Division regularly do audits of (p. 286) religious groups?

A. Not really, no.

Q. Okay. Would you know—well, no. Is the sales and use tax audited on a transaction by transaction basis?

A. It can get to a transaction by transaction basis, yes. We'll sometimes have to do a lot of sampling because of sheer volumes of records, but it goes back down to a purchase or a sale.

Q. Okay, sir, and is a tax assessed on that basis—on the basis of there being purchases and sales that were not otherwise exempt?

A. Yes.

Q. Okay, and the deficiency is always made on that basis; is that correct?

A. Yes.

Q. Okay. Now, have you ever run across the situation where you're auditing a taxpayer, and it turns out he's a purchaser—he's a vendor of goods, and he's delivered goods to a purchaser and then later invoiced them, and when he delivers the invoice, the purchaser strikes out the tax and doesn't deliver the tax with his (p. 287) check back to the vendor?

A. Yes, sir, that does happen.

Q. Okay, and what do you do in a situation like that?

A. Assess the tax against the seller, if that's who we're auditing.

Q. Okay, and is it your business as to whether he goes out there and ultimately sues that person for the sales tax that's owed, or do you care about that?

A. Taxpayers have tried to make it our business but it is not, and we have to explain that to them.

Q. Okay. So if you find a transaction which has not been taxed on the records of a vendor, then you assess a tax against them at that point?

A. That's correct.

Q. Okay, and if he can show you an invoice or some receipt that somebody else has paid the tax, then you'll honor that?

A. Yes.

Q. Okay. Now, there has been some testimony about the contract of the Comptroller with the Multi-State Tax Commission. In your (p. 288) role in the Audit Division, do you deal with the Multi-State Tax Commission on a daily basis in monitoring their activities?

A. I don't deal with them on a daily basis. I do deal with them. I've been working on this contract with them in the recent past getting some credit on the amount of money we're going to be paying to them.

Q. Is it your understanding—or what's your understanding of the types of audits that they might be con-

ducting in their audit program for the Comptroller of Public Accounts?

A. It's under a case—the National Bella Hess case which has to do with nexus.

Q. So would they be doing audits of persons who might be doing business in Texas or that might have contact with the State of Texas?

A. Yes.

Q. Okay, and would these be sales and use tax type audits?

A. Yes.

Q. Okay. Now, sir, there is a company that we're referring to as Company X that has an agreement with the MTC to remit taxes. Are you familiar—and it's a publisher of magazines. (p. 289) Are you familiar with that company?

A. I'm familiar with a company that's a publisher of books and maybe magazines, but I know the book portion that has a—

Q. Did the Audit Division or did the Comptroller's office receive monies from X Corporation pursuant to an MTC audit and then this agreement for them to remit sales and use tax?

A. Yes, we did. This is where I'm getting the interest to offset the contract payment.

Q. So you have a contract payment that you've got to make to the MTC to get into their audit program; is that correct?

A. We are already in their audit program. We are making additional payment because this is another program that is to specifically concentrate.

Q. So this is a supplementary program to your regular audit program; is that correct?

A. That's correct.

Q. Okay, but this doesn't mean that you don't have any—well, do you have any nexus type audits going on, or if your auditors run (p. 290) across situations like that, would you tell them, "Well, leave it up to the MTC" or something like that?

A. It would depend on the case. If we feel that we can get in—from the records we've seen or from the information we've obtained about a particular company and we can get in and see the records, we would do it with our Texas or out of state based auditors. If it's strictly a company that we feel is doing mail-order in the State of Texas—catalog type things, we would recommend that it would go with the multi-state work.

Q. Now, are the assessments by the MTC of Texas sales tax—do they go out under your bill? Is it a statement of accounts due—

A. Yes, we send the bill.

Q. And would that be something that they'd then have to take up with you either in the hearings process or in court, assuming that they wanted to dispute the amount of tax MTC—

A. Under this current agreement, I am not exactly sure how that would work.

Q. Okay, sir. Now, sir, you were asked whether or not you'd audited anybody recently (p. 291) for subscription sales of magazines. Is it the policy of the Comptroller to go out and audit, let's say, a special group that just came under a tax the first year after it's—the tax has been in place or they've been eliminated—their exemption has been eliminated?

A. It's not a policy, per se, to go out and immediately jump on a group that falls under the law. It's my understanding that all of the industry that is affected should have been contacted after the legislation. The only thing that we have done is under our random select program, which is part of our audit select program, we did randomly select somewhere around 400 accounts to be audited this year that were affected by the legislation passed in October of 1984—that became effective in October 1984.

MR. MENDEZ: I'll pass the witness.

CROSS EXAMINATION

QUESTIONS BY MR. GEORGE:

Q. Very briefly two questions. One, the multi-state contract that you have been talking about hasn't been signed, has it?

(p. 292) A. No, sir. We're working on it right now.

Q. You haven't made the deal? You're working on the contract hoping to get it negotiated with the other states and the Commission?

A. To my understanding, all we need to do is send it back and send our payment.

Q. It just hasn't been finalized?

A. That's correct.

Q. Okay, and the second question is Company X—the audit was not for 1985. It was for the period prior to 1985—prior to October 2nd, 1984, wasn't it?

A. Yes, sir.

Q. So it didn't include any tax on magazine subscription sales?

A. No, sir.

MR. GEORGE: Pass the witness.

REDIRECT EXAMINATION

QUESTIONS BY MR. MENDEZ:

Q. Isn't Company X paying taxes right now?

(p. 293) A. To my understanding, yes.

Q. Okay, and if they've filed returns since October the 4th of 1984, should they have included tax on any subscription sales of magazines?

A. If they have subscription sales, yes, they should.

Q. Okay, and if they are audited for a period subsequent to the last audit, would you expect it to include these receipts?

A. Yes, any publisher we audit we'll assess a tax against.

MR. MENDEZ: Pass the witness.

MR. GEORGE: No questions.

THE COURT: You may step down.

(At this time there was a brief discussion off the record, during which time an instrument was marked as Defendants' Exhibit No. 18 for identification.)

MR. MENDEZ: Your Honor, we're offering Exhibit No.—Defendants' Exhibit No. 18, which is an interoffice memo of the Comptroller's office from Billy Hamilton to (p. 294) Wanda Hutcheson who's testified here, and it involves a revenue estimate of the Comptroller's office that estimates how much money would be lost—would be—how much tax increase would arise from the repeal of the exemption on subscription sales of magazines and during the 1984 Legislative session and covering the years that are on this memo. It affects from 1984 through 1989 and—

MR. GEORGE: The only problem is you're summarizing this—magazines and newspapers grouped together.

MR. MENDEZ: No, it's magazines and newspapers together, and we're offering it under a stipulated—under an agreement with plaintiff's counsel.

MR. GEORGE: No objection.

THE COURT: All right. Admitted.

MR. MENDEZ: And, Your Honor, with respect to the deposition of Billy Hamilton that was taken in this cause, we have a small portion to read.

THE COURT: All right.

MR. MENDEZ:

(p. 295) "Question: Mr. Hamilton"—

MR. GEORGE: Which page?

MR. MENDEZ: Page three.

MR. GEORGE: Page six?

MR. MENDEZ: Three.

Examination by Mr. George:

"Question: Mr. Hamilton, would you state your full name and business address for the record, sir?

"Answer: My name is Billy C. Hamilton. My business address is 111 East 17th, Austin, Texas 78734.

"Question: How are you employed?

"Answer: I am the director of fiscal management for the Comptroller of Public Accounts."

Move on to page four, line 15. Question by Mr. George:

"What is your job responsibility with the Comptroller of Public Accounts?

"Answer: I am director of fiscal management which takes in two operational parts of the Comptroller's office, statewide accounting system and revenue estimating.

"Question: What is your educational (p. 296) background?

"Answer: I have a bachelors degree from The University of Texas at Austin. My major field was government and economics. I have a masters degree from the LBJ School of Public Affairs. It is a masters of public affairs."

Page five, line one.

"Question: When were those degrees awarded?

"Answer: I got my bachelors degree in 1973 and my masters degree in 1975.

"Question: How long have you been employed with the Comptroller's office?

"Answer: Since December 1976. It is going on nine years.

"Question: What jobs have you held during that—the employment?

"Answer: I began as an analyst in the fiscal policy research Section of what was then planning and research. I was later in 1978 made director of research in that same division. I became director of revenue estimating in November of 1982, and I became director of fiscal management in April of 1984.

"Question: How does revenue estimating— (p. 297) what does revenue estimating division do?

"Answer: The Comptroller of Public Accounts has a constitutional requirement that he estimate the revenues available to the State that the Legislature has available for appropriation during the budgeting process. The revenue estimating division—section does economic forecasting and any prediction of revenues that will come into the State over the coming biennium from which the Comptroller makes his revenue estimate."

Going on to page six at line 16. Question by Mr. George:

"Now, do you have the responsibility to determine when proposed legislation—when legislation is being pro-

posed that is in the nature of the tax alteration, either an increase in taxes—increase in the types of transactions being taxed or conversely a decrease in some aspect of the revenue raising, to make an estimate of the impact of that change upon the revenues of the State of Texas?

"Answer: Yes."

Going on to page seven at line one.

(p. 298) "Question: Was that job part of your job responsibility in estimating the effect of tax changes in the summer of 1984?

"Answer: Yes.

"Question: Did you make some sort of estimate of the effect of the change in the tax law to include subscription sales of magazines—what was—what that change would do to the revenue base or revenue of the State of Texas?

"Answer: Not specifically. We made an estimate of what the effect of doing away with the subscriptions to magazines plus newspapers would have an affect [sic]. It was a combined estimate. It wasn't a breakdown between newspapers and magazines."

On to page nine at line six. Question by Mr. George:

"Does the Comptroller's office to your knowledge have an estimate—any estimate at all about what the amount of revenue that is potentially from the sale of magazines to Texans by subscription is?

"Answer: Only in the sense that it's part of the overall estimate for newspapers and magazines.

(p. 299) "Question: Can you tell the jury how you went about making an estimate for both? You made an estimate, as I understand that, for both newspapers and magazines without breaking them out separately; is that correct?

"Answer: That is true, yes.

"[sic] Would you tell the Court and jury how you did that, sir?

"Answer: It is a fairly complicated process. The basic information that we use is a study done every ten years by the U.S. Department of Labor called the Consumer Expenditure Survey that is used to develop the consumer price index forecast that the federal government releases. It contains very detailed"—on to page ten at line one—"information on what individuals spend their money on. We took basic information on payments for subscriptions, which is one part of that, and for spending on newspapers and other periodicals the information from that—we projected it forward to the current day using inflation population growth forecasts.

"Question: As I understand it, from the information produced by Ms. Hutcheson, that you (p. 300) used this Consumer Spending Index—is that what you called it?

"Answer: Consumer Expenditure Survey.

"Question:—Consumer Expenditure Survey for the periods of 1972 and '73?

"Answer: That is right.

"Question: And you based your projections on that by taking—by making an assumption that the increase in

the consumer price index that had occurred generally had occurred in equal amounts to the sale of newspapers and magazines?

"Answer: That is true.

"Question: And then you just arrived at a number based on those two assumptions; is that correct?

"Answer: Yes.

"Question: No one has ever gone out and tried to find out if"—and then on to page 11 here—"there is publicly available information about the amount of commerce that takes place in magazine sales by subscription, is that correct, other than this particular—

"Answer: We did some. The estimate was done in a fairly short amount of time. We did (p. 301) research on available information. This was the best available information as far as we were concerned.

"Question: What other available information did you consider using, if any?

"Answer: We looked at information on sales of magazines in the state by type of magazine. We looked for information on the sales of newspapers and other periodicals in the state by type or by cost, and there is some information like that available, but it is very limited, and it didn't work for our purposes.

"Question: Do you remember what that might have been that you not—that you thought was too limited—that information?

"Answer: No, I don't recall that.

"Question: Now, do you recall how much total increase in revenue that you propose to the State as a result of the imposition of tax upon both the newspaper and magazine sales would be?

"Answer: It was about six million dollars a year for the State."

On to page 12, line one.

"Question: This is for both types of (p. 302) subscriptions?

"Answer: Right. That was for the overall exemption.

"Question: Now, since the legislation has been effective now for 11 months approximately, has anybody gone back and determined as of now what revenue has actually been collected or made any efforts?

"Answer: No, as I say, the fiscal year has just ended four or five days ago. We really don't—won't do that analysis until later in the current fiscal year."

On to page 15 at line one.

"Question by Mr. George—

THE COURT: 15, you say?

MR. MENDEZ: 15, line one.

Question by Mr. George:

"What is the level of dollars that would be significant in the scheme of things for determining the effect of a tax increase?

"Answer: First in this day and time at any tax level is significant, but the ones we will focus on in our analysis first would be aspects that raise, say, 15 million or above in a given year.

(p. 303) "Question: And what changes in the sales tax besides a rate change do you believe would fall within that category?

"Answer: Tax on repair services."

On to page 20 at line 12.

Question by Mr. George:

"One of the things that is involved in determining—is determining what the effect of the tax rate would be if you raised—if you got more money out of any particular tax obviously, and we have an increase in the tax rate generally, did we not?

"Answer: Right, yes.

"[sic] And I assume that the total package of taxes were assumed to raise certain amounts of money?

"Answer: Right.

"Question: Four billion dollars or something over a two-year period; is that correct?

"Answer: It was 1.3 billion dollars in one year."

That concludes the section of the deposition that we wish to introduce.

MR. GEORGE: We have (p. 304) nothing from this deposition.

MR. MENDEZ: We rest.

MR. GEORGE: We close.

THE COURT: All right, gentlemen, then I'm going to let this matter be presented to me. You can argue it tomorrow at 9:30 in the morning.

MR. MENDEZ: Thank you, Your Honor.

MR. GEORGE: Thank you.

(At this time the proceedings were adjourned until 9:00 a.m. on February 5, 1986.)

(p. 1) NO. 378,384

TEXAS MONTHLY, INC.	)	IN THE 345TH
	)	
VS.	)	
	)	
STATE OF TEXAS, BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS, JIM MATTOX, ATTORNEY GENERAL OF THE STATE OF TEXAS, ANN RICHARDS, TREASURER OF THE STATE OF TEXAS	)	JUDICIAL DISTRICT
	)	
	)	TRAVIS COUNTY, TEXAS

STATEMENT OF FACTS
VOLUME THREE

BEFORE THE HONORABLE JOE B. DIBRELL, JR.

APPEARANCES

MR. R. JAMES GEORGE, JR. AND
MR. ERIC G. BEHRENS,
Graves, Dougherty, Hearon & Moody
2300 First RepublicBank Tower,
Austin, Texas 78701

ATTORNEYS FOR THE PLAINTIFF

MR. DAVID MENDEZ AND HARRIET D. BURKE,
Attorney General's Office
210 Barton Springs Road,
Fourth Floor,
Austin, Texas 78704

ATTORNEYS FOR THE DEFENDANTS

(p. 2) BE IT REMEMBERED, that on the 3rd, 4th and 5th days of February, A.D. 1986, the above numbered and entitled cause came on for hearing before the HONORABLE JOE B. DIBRELL, JR.

WHEREUPON the following evidence was given and proceedings were had, to-wit:

(p. 3) MR. GEORGE: Your Honor, let me begin with a—what I think is a simple and responsive part of this case, which is the religious periodical exemption, which I've written up here and—

THE COURT: All right. I've read those cases.

MR. GEORGE: And the cases—I have not—and if I had, I would have found one, and I think if Mr. Mendez had found one, he would have cited it, too—found a case in which we have a Court that dealt exactly with the kind of situation we have here with a clear—and there's no question this is a content—that's what it has to say—based discrimination. All of those are contents. It has to say those words to get the tax exemption. I have found no directly in point case with a tax exemption dealing with this sort of thing, and Mr. Mendez' brief doesn't cite one either, and there aren't any directly in point because I don't think—I think this is a unique statute that I could find. We've gone through all of the State case laws, and I found a few sales tax exemptions for Bibles that have never been (p. 4) challenged, and that's it. We're dealing with—

THE COURT: All right. That's my first question. Maybe you can satisfy me very quickly and go on with the cases you've cited and just this: Except the argument that

this does, in fact, require a content determination, obviously your client is not claiming that in one sense that he is—he's not entitled to an exemption?

MR. GEORGE: No.

THE COURT: See, now, that's my problem there. He's not coming in on the idea that "All of a sudden I asked for an exemption, and they wouldn't let it because they examined my content and said, 'No, it doesn't meet the test' "?

MR. GEORGE: No, sir, the test is—well, mine is—and I haven't tried but I admit mine would not meet the test. I mean, there's no question that we—my content wouldn't meet the test, and there's no doubt about that because it's not—I mean, it's not teaching a religious faith, and there's no question about it.

The question is what do (p. 5) you do when you have a content based governmental regulation based on speech. Now, I believe the answer to that question is really easy because—and the case law supports what I think the rule is. That part I do have cases on. The classic case and just as Marshall wrote in that Mosely case, Mr. Mosely was out there carrying around a picket sign and talking about school student policies. They passed an ordinance that—there's no evidence in the record was directed to one man for picketing that school. They then had—he brought an injunctive action to enforce—to enjoin the enforcement of the ordinance. The Court said, "You have in the ordinance a content based discrimination. The remedy is you can't have—you've got to give everybody the exemption that is in the same circumstances, and the content on

the sign can't be a basis for making decisions. Therefore, everybody gets the exemption that is picketing that has something on the sign."

Now, it didn't deal with the problem of the ordinance's regulations on how far it had to be away or the other parts of the ordinance that don't deal with the speech, (p. 6) and in our case just like in the *Speiser v. Randall* case, the old McCarthy era, it's a tax exemption. The veterans that wouldn't sign the oath that had taken the advocacy of those positions weren't seeking to prevent everybody else from getting the exemption. They were getting—they wanted the tax exemption themselves, and that was a relief granted; that is, they get the exemption, too, because you can't have—decide the rule based upon what people say—simple.

Here we say we don't have those words in our magazine. We don't consist wholly of teachings sacred to a faith. We are entitled if somebody—and there's—the facts in this case are not disputed. Ms. Hutcheson testified that there are periodicals out there that qualify. She knows about them, and she testified that people had called her up, and she knew about it, and part of her job was to know about it, and they were there in the course of her career. So there's no question it's a hypothetical exemption. There are people taking advantage of it according to the record in this case, and Ms. Hutcheson clearly testified to (p. 7) that. Mr. Gerhart testified he had purchased those, and we introduced—so that part we have a real controversy with a real exemption that real people are taking advantage of. We have another person, Texas Monthly, Inc., in that same situation. They are periodicals.

Now, Mr. Mendez' argument in his brief regarding this really says we have the—he breaks it down into two parts. The first argument is the Legislature has broad power, and if you look on page 29, "An equally established principle of constitutional law is inherent in the exercise of the power to tax. The State Legislature is free to select the subject of taxation and to grant exemptions." He relies on the broad Legislative power to manage their tax policy. Now, there is no—I don't dispute that that's a broad power, but that power operates differently—and that's the teaching of the Speiser case—when you have speech based decisions. If we're talking about shoes, we have the tax on sandals and not on oxfords—that the Legislature has virtually unlimited power to do that, if they so choose, but we don't have the same—that's what the (p. 8) First Amendment's rule is. That's part of the same compelling reason—compelling interest argument. They need some compelling reason to do this. Well, the only reason—and nobody has gotten up here and tried to justify it because on its face the only basis for that is the promotion of religion—not good activity but religion, and that is a banned objective of government.

THE COURT: It's supposed to be nuetral. [sic]

MR. GEORGE: You can't do that. Now, I think one of the profound reasons why this exemption operates to make it unlawful to tax periodicals—until the Legislature simply abolishes—they can have a special session, abolish that and this argument goes out of the case, if they so choose, and they had plenty of time to repeal that in the summer of '84 when they repealed the other exemptions on periodicals, but until they do the remedy is periodi-

cals, whatever words they are, get the same treatment as these periodicals. That's the remedy the Court grants. Now, the argument that on its face—and Mr. Mendez really doesn't (p. 9) push but—and suggests is that they have—it's traditional to give tax breaks to religion. Religious churches are exempt from ad valorem taxes and other things. The Walz case, which is the Supreme Court case saying that's not establishment, talks about—and Justice—Chief Justice Berger's opinion goes through it. Well, that's part of a long tradition, and it's a part of a general system of good works—being treated—giving tax breaks to encourage them to kind of—

THE COURT: Can you put it in the category of charities, as well?

MR. GEORGE: Yes, and you look at Section 310, which is the general exemption up here—I think it's 310—religious up at the top of that page on the left-hand side—religious, et cetera, et cetera, and it's lumped in there with charities and the solar energy and other things—athletic competition and other things that the government wants to encourage because of their activity. It's not an exemption all periodicals are subject to tax in this state that consist of words other than this. That's the—and it's (p. 10) simple, and I think the reason there aren't any direct cases in point is it is so simple. No one else has done that to pass a pure speech based exemption. The California people did. I mean, that was clearly—you had to say the right words or not say the right words in that case, or you didn't get it, and that went out, and I don't think any other Legislature has tried. That's one reason there's no such thing. Why they decided when the crisis

tax—sales tax rule back in the '60s the first time, do this, I don't know.

THE COURT: Well, they just said periodicals or publishers should be divided by a religious faith without the other.

MR. GEORGE: That's—my argument would—that would be perfectly fine, if it was part of periodicals published by religious faiths—

THE COURT: Charitable organizations?

MR. GEORGE: —the Boy Scouts and the American Cancer Society and all of those people got the same treatment as churches, that's perfectly okay. They didn't (p. 11) regulate what they said, and it was based upon the good general charitable category, which is what the constitution of the State says under the one I've referred to in my brief and the cases on it. That would be fine, but it would have to have two things. It would have to have more people in the category than these, and it would have to omit this language because it couldn't regulate what they said. You could say—and they might have it for profit or something, but they can't say you get tax preferences because of what you say, and that's simple, it's easy and, I think, disposes of this case.

His argument that the remedies—we have to declare the whole—that we get—all of these people are not exempt anymore—that kind of argument has been dealt with, and there's a wonderful Texas case that is from the old days of railroad taxes and contains exactly the same kind of argument the State made in 1881 involving the Pullman Car Company, and there's a provision in the consti-

tution, Article 1—Article 8, Section 1 says, "All taxes will be fair and equal." Article 8, Section 2 says, "All occupation taxes shall be fair and equal," (p. 12) which deals with taxing lawyers and doctors differently, et cetera, and they had a—and those constitutional provisions are different than the Fourteenth Amendment and have been in the law—different than equal protection. They have been in the law of the state since before it was a state and the Pullman case involving a tax on railroad cars not owned by railroads. There was a tax—the Legislature passed a tax that all railroad cars not owned by railroads had to pay taxes, but if you owned a railroad, you didn't have to pay it. The Supreme Court said, "if you're in the business of having railroad cars, you've got to be treated the same way. Whether you own a railroad or not is not a rational basis for distinction." The Court—and the argument by the Attorney General was, "Well, the remedy is to declare the entire tax system unconstitutional or to simply deny the exemption to the railroads." The Supreme Court said, "No, the Legislature has decided not to tax the railroad company. So we can't tax them. The remedy is not to tax the Pullman Company either who makes—owns cars but no railroads until they tax the railroads. (p. 13) When they do that they can tax everybody the same," and I have a copy of that case and highlighted some of it. That has been followed, and they're not too—these cases are—kind of come in periods of economic crisis in this state or change in this state, and the other classic case involving the same holding that comes to the exact same conclusion is the old chain store taxes passed during—in the—during the depression era, in which they went around and taxed people who had branch

stores differently, and various exemptions from those were under attack under the same Article 8, Section 1 and 2 provisions and they—this is a Dallas Court of Appeals case. It didn't have any history, but it is the classic law in the case following Pullman. It says, "Look, the remedy is when they take out the unlawful exemption, everybody similarly situated will be taxed, but we don't have to declare—the only part of the tax that gets declared unconstitutional or unenforceable or you can't collect the tax are those that are integrally related to this—the unconstitutional provision here, and the only people that would be affected is somebody (p. 14) classified as periodicals." So this is the *Hurt v. Cooper* case. Mr. Mendez cited it and gave you a copy, I believe, but here's another copy.

Now, so in sum I think this is an easy argument. I think it disposes of the case, and the Court needs to go no further, but given the nature of this case, we have the two arguments on the Fourteenth Amendment and under Article 8, Section 1 of the Constitution of Texas are both very related. These arguments essentially are the discrimination of this tax, okay, and as I said when I set out before we started, the tax on its face is nuetral. [sic] We are—there is no special singling out of magazines. They're just treated like everybody else. It's the implementation of the tax that we are complaining about, and that's what all of the evidence has been is that we're talking about how the tax is operated. It does not operate in this—in a fashion to be equal.

Now, this is a case in which the facts need to be reviewed. What has been the testimony? My elements of proof under this provision were unequal tax, unequal ad-

ministration that—intentional. That's not (p. 15) deliberate but intended. They know what they're doing and know that it operates that way. A choice has been made in effect and harm. I had to prove those two facts. Now—or two and a half facts, however you would submit that on a special issue. Probably submit it as three issues. Now, here what is the evidence? Again we have clear testimony from the Comptroller's personnel on the unequal. What do we have? We have two—we claim two kinds of unequality. We claim they—you didn't—out of state people, publishers are not required to collect, one claim, and the next claim is I don't think there's any serious argument. Not a witness testified of anything they've done. They haven't done a thing to go out and collect the tax. Everybody said they knew salesmen were in the state. They knew order takers were school kids. That's no question they knew that. Mr. Gerhart went over and told them that. Their own personal experience—Ms. Hutcheson—people had come to her door. It's a common experience. Everybody—I mean, it's almost judicial knowledge that there are people coming to everybody's door trying to sell them magazines, (p. 16) and they have a whole list of subscriptions. That's—I mean, it's almost judicial knowledge to that fact. Everybody that got on the witness stand knew that that was going on, and there is no question that under the statute and under the cases that some nexus—they say, "Well, nobody says that we don't know about it, and nobody says that we don't—we try to collect it." They say, "Well, there may not be nexus." Their own statute says order takers give nexus. The general counsel, Mr. Anderson, gets on the witness stand, and he says, "I'm familiar with the Scripto case, and I know that independent contractors give them nexus, and I know

that that's what the statute says, but there may be a complication if they are not"—some sort of privity argument. Cases to support that? "There may be some, but I wouldn't take that legal position." That's the position they've taken. "We haven't done anything about it. We know it's happening. We haven't done anything about it." Mr. Castlebury—every witness—Mr. Castlebury, Mr. Harold Lee, the man—the auditor, Mr. Shankle—Glen Shankle, the young fellow that was the enforcement guy—everybody (p. 17) said, "We do this intentionally, and we know it discriminates. We know"—Castlebury, Ms. Hutcheson—all of them said, "We know it discriminates against Texas publishers." Everybody said that. That's the unequal—has been—I don't think there's any question that the preponderance of the evidence has been—

THE COURT: There's been argument that it's because it's uneconomical for them to—

MR. GEORGE: Well, their argument is—there is a second part of our argument is consumers owe a tax. Now, I think their whole argument on uneconomic was to here. I argued this, too, and the Legislature decided to make the—

THE COURT: Well, see, your client argues that also. It's uneconomic for them to try to collect.

MR. GEORGE: That's right, and there is an uneconomic—I think the evidence is they don't know really. They haven't tried.

THE COURT: Well, I think Justice Brennan or somebody said in their—(p. 18) thought that that was some-

thing you could call—take a few minutes from an auditor to know it was uneconomical—

MR. GEORGE: Probably would be uneconomic. We are dealing with a problem of First Amendment protections that is difficult because we—getting to their—Mr. Mendez doesn't really argue that I'm wrong on the facts. When you look at his brief, he doesn't really argue that's not happening. He simply says there's a rational reason. Now, the question is does the rational reason test apply? I think that's the teaching in *Minneapolis Star Tribune v. Minnesota Tax Commissioner* is that the rational reason doesn't apply, but the facts again—they haven't tried. They haven't tried to do it, haven't tested, haven't encouraged voluntary compliance, and one of the things that—the cases under the Fourteenth Amendment need to be read, and those are the cases that he relies on on this unequal—out of the poultry—the chicken company case out of Alabama and the Supreme Court cases that talk about uneconomic are in a context that it doesn't take into account our history of Article 8 of the (p. 19) Constitution of Texas, which is unequal taxation is specifically—I mean, we have an equal protection clause in our constitution. We've gone beyond that. We have a special provision on equal taxes in the Texas Constitution and if the—look at the City of Arlington cases. Look at the history of that litigation, and it has to be on—there was a long and difficult history in this state of trying to tax intangible personal property.

You remember, as I do, that everybody was supposed to render your bank account, your cash, your household furniture. All of those properties were subject to tax in

this state and were until 1974, and when the current Legislature—the people amended the constitution to exempt them all. They hadn't been able to collect them. The cases in Texas, however, are that the tax collector must have a system of trying. It's a voluntary tax system. Nobody has ever said that they have to go out and levy execution on everybody or they have to audit everybody. They have a system of—they have to have a system that tries; that is, a part of their system is collecting from these (p. 20) people, too, and that's the problem is it's not even a part of their system. They could have ads in the paper, encourage voluntary compliance. They could have come in here with—it's been 25 years since 1961 when we had this tax. I believe it was '61 when we first passed the sales tax. Not one shred of economic evidence that they've ever tried at all, ever run any tests, ever done anything. I noticed the other day—this is not in the evidence but you probably—everybody probably would admit it's true. I took my wife down to Laredo on our anniversary, and she wanted to shop over in Mexico, came across, and there's a man from the Comptroller's office collecting a liquor tax.

MR. MENDEZ: Well, I'm going to object to that because he—we're trying to argue about something here that, you know, is a record, and that just brings in stuff that doesn't have anything to do with this case.

MR. GEORGE: And nobody has a system of asking you about anything else.

THE COURT: I'll let you get a little leeway, too. Don't worry about it. This is a bench trial.

(p. 21) MR. MENDEZ: I just feel it's unfair bringing in stuff that doesn't have anything to do with this case,

and it doesn't have anything to do with the testimony presented in this case.

THE COURT: Okay.

MR. GEORGE: There's no system to encourage—to take—they act like it wasn't a part of the law. That's the problem. Now, but when we turn back to number one, no uneconomic argument. Did you hear anybody say we couldn't collect from *Reader's Digest* enough tax to send an order up there to collect it? Was there any evidence to that effect? No. Was there any evidence that would we couldn't send to the publishers of *TV Guide* and Meredith Corporation or some of these others not to collect the tax from them? No. From *Newsweek*. No. From *McCall's* magazine? No. They didn't say that because it would have been ridiculous to say that. They don't have any reason except some argument that there may not be nexus, but they know there's nexus. They know it. There is nexus. It was established conclusively. They have solicitors in Texas. Now, they say, "Well, (p. 22) we have"—"we think we're going to sign an agreement soon," Mr. Lee's testimony is, "with the interstate"—"and we hope to have them audited someday," but that's simply not good enough.

The taxes in question are from October of '82 to now —October of '84 until now. During that period they certainly haven't had any plan. They didn't have an agreement with the multi-state tax. They had a plan not to do it. Mr. Gerhart goes over there and says, "Please, do it. Here are all of these people. I'm competing with them. It's going to hurt me. Please, go ask them to pay their

taxes," and what did they do? Nothing. Two days before Ms. Hutcheson's deposition in this case she sent out a bunch of form letters to those people, and that is it. No justification exists—none. They haven't given any. Now, when we put these two facts—established facts into the context of the First Amendment and Fourteenth Amendment and the Minneapolis Star Tribune case and look at what does that do, Mr. Mendez' argument again is ,"Well, we"—you know, it's "Tax people have lots of discretion. It's a hard life out (p. 23) there to collect taxes, and we've got to have lots of room to make decisions, and we've just decided that we'd be better to put our resources some place else, and we're not going to do it that way because it's just not"—"I don't really know why they're not going to do this, but they're not going to do this because they just don't think it's cost effective, and they'll get around to these people some time when it gets down their list." The enforcement chief, Mr. Shankle up here—"We're going to get around to them." "When? Do you have any plan?" "No, some day." Maybe, you know, manana [tomorrow] defense—sort of do it on manana, [tomorrow] and nothing, nothing, nothing is here on what they're going to do or when they're going to do it or how they're going to do it and no justification for it, and he says, "Well, we've got wide discretion," and cites a bunch of cases that say, well, wide discretion, rational reason, and, you know, I'll have to admit if I was in here with a shoe case—shoes versus sandals or something, the case law is they do have wide discretion in regards under the Fourteenth Amendment at least. I want to point out there's almost none of those (p. 24) cases under the Article 8, Section 1 of the Constitution of Texas. That's not the way this state has treated

them, but this isn't shoes. These are words. This is the press and this—the Supreme Court after many years—I mean, this is not an ancient case—the Minnesota Star Tribune case. They said, "Treat them equally. Treat the press the same as everybody else, and if you don't, different taxation of the press places such a burden on interests protected by the First Amendment that we cannot countenance such treatment unless the State asserts a counterbalancing interest of compelling importance that cannot be achieved without such differential," and they specifically said, "Raising money is not enough." Different treatment of the press has been established. There's no question we've been treated differently. Under the economics of this industry, they can't collect the tax. There's no way to organize their business and stay in business and collect the tax and must pay it essentially as a gross receipts tax. Now, there's no question that particular press or magazines—it works like a gross receipts. (p. 25)Ms. Mizwa comes in here and she says, "I've been trying. I send them notice and calculate the numbers, and 98 percent of the people don't pay me. I can't go collect that tax. It puts me out of business to collect the tax." Particular members of the press—does it discriminate against particular members of the press? *Texas Monthly* versus *Reader's Digest?* Yes, it does. Mr. —you know, Mr. Castlebury says it discriminates. Ms. Hutcheson says it discriminates. Everybody admits it discriminates the way it's operated. Particular press, it does.

Now, we get to what justification for that discrimination, and they don't have any. They say gross receipts is too costly to do something else, and then they cite a case called the Canteen Company case, which is a Supreme

Court of Texas case, and contend that, "Well, we have chosen to be in the business we are in, and it's just tough luck that we can't collect the tax," and that's essentially the tough luck argument, and, one, I want you to read the American Canteen case, which Mr. Mendez has supplied you copies of, and in that case the (p. 26) Supreme Court dealt with the problem of the vending machine industry, and it had candy bars for sale for 25 cents and they were—and the bracketing system in the state didn't allow you to collect the tax below 25 cents in those days. Nothing is 25 cents anymore, but they said that they are in the same position as any retailer who chooses to sell their product under 25 cents because nobody was allowed to collect the tax under 25 cents, just as Stakely for the Court said that the effect and results or a lack upon retailers of the same class engaged in the same type of business. There is no more discrimination against respondents selling items of 24 cents or less than it would be against a retailer selling items between 51 cents and 72 cents where a portion of the tax would have to be paid by the retailer. They said, "They are in the same place as everybody else," and therefore it wasn't unconstitutional. The main issue in this case was what did the statute mean, whether or not there was a tax below 24 cents, and they resolved that in favor of the taxing authorities. I don't believe this case says that but again compelling interest. They know (p. 27) it discriminates. It discriminates against local publishers, and I want to call you finally on this issue: You remember Mr. Shoemate that was up here yesterday—the guy who heads the East Texas office? He got a memo. What did it tell him to do? To go out and find solicitors for national magazines? Which magazines did it tell him to go audit?

Local magazines, and if you'll look on it, it's picked out two on the instructions to go audit, *Texas Monthly* and *Third Coast*—the exact kind of people that discrimination works against.

It seems to me this is an easy case. One, we have a content by discrimination and no real justification for it. They simply say I'm wrong about the remedy. We have discrimination that they admit, and they admit it's intentional. Their only justification is—for not collecting it from these *Reader's Digest* people is some argument—and I don't really understand it—vague argument that nexus is a gray area. Nexus is difficult. Nexus is hard, but it's not—they've got people in the state soliciting orders, and that's clear, and their general (p. 28) counsel knows it, says it, and "We just"—"We haven't done anything about it, and we intend to do it"—Mr. Wade Anderson. He said he intended—that's what he intended to do. So did Mr. Castlebury.

We have what to me is a—I don't think is a critical part of my case but a critical issue for the State of Texas is the Legislature has passed a tax that the taxing authority is ignoring. Now, there may be a good reason not to have this tax because it's hard to work. It doesn't work very well, and it's hard to collect or something, but is it Mr. Bullock's job to simply say, "I'm going to instruct my whole system to ignore it," particularly when it discriminates against people who publish in state magazines in the free speech area when he knows that's what's happening? No, that's not right, and finally does it harm us? It's clear it harms us. Judge, you can see it harms us. We pay the tax. Nobody else pays the tax. If that isn't

harm, I don't know what harm is. Harm—we had a very qualified consultant come in here and calculate what it says does to the value of the corporation. He came up with a (p. 29) specific number, $3,100,000, and is there any evidence from the other side, any analysis of our organization by the other side, any rationale why it doesn't harm us from the other side? No other evidence. So we've got harm proved. I mean, they don't even contest it. The truth of the matter is they don't even come up here and contest it. It seems to me that we proved all of our elements of the case, and it seems to me that we didn't even need to. It's unconstitutional in the first part to begin with. Thank you.

MR. MENDEZ: If I may approach the—

THE COURT: Surely.

MR. MENDEZ: Mr. George cited the wrong page in my brief for the proposition that we're trying to urge on this religious periodicals exemption. Esseatially the argument is on page 30, and it says that "Constitutional provisions and statutes granting exemptions from tax are always strictly construed to the end that such concession will neither be enlarged nor extended beyond the plain meaning of the language employed," and (p. 30) I've cited an old case on that proposition—well, 1971, and then, you know, into texture because there's a very basic constitutional law concept that applies to taxation, and it's pervasive through all taxation. Anytime you pick somebody to treat him differently, then you look at that in a very strict manner. The Court, in construction of those—and I'd urge the Court to go into texture into those areas. You'll find that the

mechanism for judicial review of these is if you can't logically fit everybody into what is a religious faith or into—or their publications into something that promulgates teachings of a faith through common logic, then the exemption faults. It can't be enlarged. You can't bring other people into it, but it doesn't—it can't be—it's void. You're judicially declaring it void, if it's in an unconstitutional manner discriminating between one person and another. I've—the statute does say exactly what Mr. George says. It says—it does say that it would be a document of religious faith that had certain types of writings in them, and if the Comptroller had sought to follow every word of (p. 31) that statute, he probably would have to go read them and figure out which portions were commercial speech, let's say, versus religious speech. He applies it. He applies it in a manner where he tries to avoid entanglement with religion. He doesn't want to go in and try to decide whether some of these—

THE COURT: Well, I'll grant you that it's her testimony that she doesn't want to do so, but that's not the test, though, is it—what the person wants to do?

MR. MENDEZ: Well, she doesn't do it. There was no testimony that any Comptroller employees ever goes in and looks at a document. There were a couple of exhibits introduced through Mr. Harry Gerhart—

THE COURT: I think it's just question on the telephone. I think it came in asking what it was about and what did it say or something—

MR. MENDE: And the testimony, as the Court will remember, was that we're not—you decide for yourself.

If you're an exempt organization under the other religious organizations exemption, then you're free to (p. 32) make your own decision about what you're publishing, and it kind of makes sense because those people get to buy things free. They get to sell tax free and use them tax free in most instances.

THE COURT: Well, the Court—I recognize that, and of course, Counsel, you're stuck with what the Legislature has done here and I'm not—

MR. MENDEZ: And we haven't carried it out, and the testimony is we haven't carried it out the way the Legislature has done. If Your Honor wants to order the Comptroller to go in and check everybody's periodicals and make sure—

THE COURT: No, I'm not going to do that. Obviously I can't do that. In fact, I recognize if that's what it is, it's unconstitutional.

MR. MENDEZ: And then it really gets—I mean, then we don't have any argument. The argument is if this is discriminating against *Texas Monthly,* one remedy: Get rid of that exemption through judicial voiding. You say this is an unconstitutional (p. 33) protection of a specific group from taxation that works to the detriment of Mr. Gerhart's magazine, and that's the remedy. You can't—because if you look at it logically from the other side—

THE COURT: Well, am I—I'm being asked to say that it discriminates is what I'm being asked to say.

MR. MENDEZ: What's the remedy for that statute? Judicial voiding, judicial repeal. If you don't do that,

then what's a periodical? What's a religious faith? If *Texas Monthly* fits in this exemption, if you're going to expand it to include everybody so that they don't have to—if you're going to expand it to include it so that *Texas Monthly* is an exempt organization within 151.312, then what's the—

THE COURT: Well, let me get this straight because I want to know the mechanics of it. It basically is that the plaintiff is asking me to so interpret that provision that it's—the test is set up to determine on content of the writing, and that is prohibited?

(p. 34) MR. MENDEZ: Yes, sir.

THE COURT: And that follows periodicals that have this. So what they're really asking is not that I don't—that I say that all periodicals are taxed but that they come within—they have to come within it because you can't set up an exclusion of periodicals and then say, "Well, but we're going to exclude certain"—

MR. MENDEZ: That's exactly the argument I'm making, Your Honor. We have a sales and use tax scheme that applies to all taxpayers, all citizens of the State of Texas. There is a provision, 151.312, which is one of the exemptions, and what I'm stating under the law—under *Herren v. United States* under the pervasive interpretation of exemption law in taxation this is a favored classification. They're being treated in a favored manner. If you want to correct the statute, it has a severability clause. If one portion is held unconstitutional, then the rest of the act can operate—

THE COURT: I don't think the severability applies to me to start severing (p. 35) up a paragraph, now, does it?

MR. MENDEZ: That should get rid of the whole statute—get rid of that whole exemption, 151.312. Make all religious periodicals—make all publishers of religious periodicals that are religious faith pay taxes, if that's what you want to do, because if you open it up and include *Texas Monthly,* then who's next? Is the *American-Statesman*—they write also. They've got different content. Do they fit in there? Is the *American Law Journal* a religious periodical? Does it talk about sacred teachings of a faith? That's the argument that it doesn't make sense to expand it to include *Texas Monthly.* The only remedy that *Texas Monthly* can seek from this is to have churches and other religious groups—

THE COURT: Of course, a newspaper is not a periodical.

MR. MENDEZ: Well, Your Honor, any magazine—I don't know what a periodical is, and that's not at issue in this case. All I'm saying is that they write also, and is there a rational difference between publishing on a monthly basis versus a weekly (p. 36) basis or a daily basis? I don't know. I just don't know where you stop when you open it to include *Texas Monthly.*

I'll go on, Your Honor.

THE COURT: Go ahead. Excuse me.

MR. MENDEZ: Speech based decisions on a compelling State interest is a test that we urge does not apply in this case. Minneapolis Tribune was one case, and

freedom of speech lawyers like it a lot because it was a tax. There was a tax on the newspapers on their use of ink and paper and—

THE COURT: You're a freedom of speech lawyer, aren't you?

MR. MENDEZ: Your Honor, I have nothing to do with freedom of speech law, but it keeps getting cited, and there's been cases subsequent. I gave you a copy of the North Carolina decision. That's fine. It's already served its purpose. There was a tax put on newspapers in Minnesota that harmed them, and that tax was operating against that one—those six newspapers in Minnesota because they published a lot of words is what it turns out. (p. 37) Compelling State interest is fine. That's a great test for Minnesota for that one fact situation—no applicability here.

We're talking Article 8, Section 1. We're talking First Amendment equal protection. State action in taxes—we deal with the rational basis test. Look at that North Carolina case. Look at the other cases that occurred before the Minneapolis Tribune. This is a one-shot deal, the Minneapolis Tribune, and I don't think it needs any more mention. What we've got is a rational basis test that applies here, and all the Comptroller has to do or the Legislature assuming—I get a feel that sometimes we're going after statutes, and sometimes we're going after the Comptroller's application of the statutes, and I never can get a real feel for the plaintiff's argument in this case, but let's talk about application of statutes. Has the Comptroller unequally administered—that's an as applied argument right there—in an intentional manner the tax—

the use tax collection scheme to *Texas Monthly* versus anyone else that is similarly situated? The one thing we always get past in this (p. 38) analysis, and which is just as important an element here, is that it's got to be similarly situated. These people have to be in the same class. If the Comptroller seeks to make different classes of persons, then he's got to have a reason for doing it. He's got to have a reason for making different classes. If he's going to—if everybody is within the same group of persons, then they'd have to be treated the same. He can't make any excuses. I want to turn to page—

THE COURT: Well, isn't *Reader's Digest* and *Texas Monthly* in the same place?

MR. MENDEZ: I don't know what *Reader's Digest*—there's no evidence. There is not one shred of evidence that *Reader's Digest* has a contract with anybody to be doing business in Texas that says that that—

THE COURT: What about all of these clearinghouses and all—that people are going out soliciting—

MR. MENDEZ: What—what's—I'm sorry. What's the nature of the contract that underlies their being there? I don't know. (p. 39) The only exhibit we have—

THE COURT: Well, what about the Scripto case, though, that even if you have a contract and you're independent and you show there's supposed to be a complete separation, you're still held accountable?

MR. MENDEZ: That's what I'm getting at, Your Honor. I don't know what the relationship of *Reader's Digest*—

THE COURT: The test is not what the relationship is. It's just whether there is a relationship.

MR. MENDEZ: Well, we don't know. I don't know if there is a relationship. They show up on that exhibit, but other than being there, nobody here was qualified to decide whether there was—whether that scout troop that had that—owned that magazine and was selling it in its own right for *Reader's Digest* or whether there was somebody else other than *Reader's Digest*. I don't know. The only exhibit we had about how somebody might come up—

THE COURT: What about our definition here with reference to nexus and as (p. 40) to what contract has to be?

MR. GEORGE: That's 151.107, I believe.

MR. MENDEZ: Subsection B says representation in the State of Texas.

MR. GEORGE: Soliciting orders, it says.

MR. MENDEZ: Well, it constitutes nexus. The person that was soliciting sales in Texas—

THE COURT: Well, wouldn't that be enough at least to prompt the Comptroller or someone to make an inquiry of *Reader's Digest* or you selling—

MR. MENDEZ: I agree with that, I mean, if somebody had time, and that was one of the things is nobody had ever checked out—

THE COURT: Well, that puts them in the same class is what I'm talking about, doesn't it, at least initially to make some investigation?

MR. MENDEZ: There's no evidence that *Reader's*

Digest and *Texas Monthly* are in the same class of persons in this state. The reason—the one shred of evidence, I guess— (p. 41) it might be a mistake—the one shred of evidence that *Reader's Digest* might have a contact with the State of Texas is that its name shows up or may show in one of the *Reader's Digest* or Quality School Plan exhibits that was introduced in this case. There was nobody that was put on the stand to show the relationship between that name on that list and *Reader's Digest*. There was one exhibit on the defense side that we put on where we contacted *Reader's Digest,* and they affirmatively denied that they had any contacts of any sort with the State of Texas. Now, that—

THE COURT: What about Corporation X or Company X?

MR. MENDEZ: They have contacts with the State of Texas. They have entered into an agreement with the State of Texas, and they're paying taxes today. They're in the same class. They're being treated exactly the same way as *Texas Monthly*. That's what my main problem is when we move over here to this page. Sure we've got unequal treatment somewhere, but I don't know who he means—who *Texas Monthly* means by out of state publishers (p. 42) not being required to collect.

THE COURT: The evidence shows what came in. What I'm just trying to—is at least those who have a nexus—or at least the indications are that they have a nexus and therefore—

MR. MENDEZ: Let's get rid of the other group first. There was a little vagueness, I think, in Mr. George's

mind about who this group was that's not being required and why they might not be required. Well, it's not vague. It's the Federal Constitution. Interstate Commerce clause says that if you don't have contacts—if you're out of state and you don't have contacts with the State of Texas, you can't be required to collect use tax for anybody. Well, that's a pretty good reason for not going after that person. There's no evidence as to whether *Reader's Digest* fits above the line there and is protected by commerce clause or not because we haven't gone out and audited them yet. That's fine.

Let's get into this other group. Mr. Wade Anderson testified that it's a difficult area. Nexus is a difficult area. (p. 43) Your Honor probably notices the effort that *Texas Monthly* has gone to to prove up this case and to prove up their position on tax or nontax liability and our defense of the case. Every one of those nexus audits is being done by the MTC or that will be done by the MTC is probably going to generate a lawsuit just like this one—the same types of issues. Is it—it's just a matter of time when the MTC gets an assessment for Texas, and then Texas issues a letter that says, "You owe Texas tax because you've got contacts." Then we're going to be right back in here, and all of those people are going to be treated the same way as *Texas Monthly*. It's part of the audit scheme. It's part of the enforcement plan, and when a few of those people get seized or closed down or whatever the Comptroller can do to them, then hopefully everybody will fit. I don't know what nexus anybody other than *Texas Monthly* has with the State of Texas because that's the only person that testified on its nexus. Well, no I know three other persons that have nexus with the State

of Texas—Southwestern Art, Inc., which publishes the Reaganite—I mean, the magazine (p. 44) for the Reaganites and the yuppies, and we've got *D Magazine* and *Houston City,* which are published by Southwest Media Corporation. They've got nexus with the State of Texas. They collect tax. They've got the same harm—the same presumed harm.

THE COURT: Well, let me get the record straight. I read *Southwest Art,* and I'm not a Reaganite.

MR. MENDEZ: Well, whatever it is. Essentially I was just trying to remember what it was, but the deal is those people are doing business in the State of Texas such as to bring them under the statute. We know about them because they were here. There's a statement there's people out there not paying their taxes that have nexus with the State of Texas. Where were they? Where's the evidence, and you need to show that to show that there's another group of persons out there. They weren't here. There wasn't anybody that could tell us about them.

Mr. Lepere—okay, he mentioned *Architecural Digest,* which is published in—what was it—California. He (p. 45) says that's one of his clients, and he doesn't know if they collect tax or not. I don't know what their contacts are with the State of Texas. Mr. Lepere couldn't explain for us what the contacts of that company were with the State of Texas. I don't know. Maybe *Architectural Digest* has contacts.

Here we go into another class of persons. Consumers owe tax, and they aren't paying their taxes. Judge, if you don't pay your taxes, I, *Texas Monthly,* don't want to

pay my taxes. If you don't drive 55, I don't want to drive 55. Until everybody pays their taxes, I don't want to pay mine. I don't want to be the first one. Not much of a taxing scheme to work with, if that's the constitutional law that applies that you can—you can't enforce a statute that's on the books because the defense is my next door neighbor didn't pay. That's the argument that's being brought up here because this certainly wasn't part of the pleading. The classification that's in the allegation was, "We're being treated differently from out of state publishers because they aren't collecting the tax." When we showed (p. 46) that they were being treated the same—anytime anybody had nexus they had to pay the tax—and that was the testimony from Mr. Shoemate and Mr. Shankle and Mr. Anderson and from Hutcheson and everybody else. If they find them, they're going to make them pay. Then we had to go and find out, well, there's another person. Judge, you aren't paying your taxes, and so you've got to be brought— and until you pay them, I don't want to pay them—another class of persons right here, and that's where all of the argument and that's where we spent yesterday afternoon.

You can take judicial notice of the fact that Mr. Bullock can't collect the taxes from the consumers. That's what the Supreme Court of the United States did. You can prove it up, which is what we decided to do because we wanted to show the absurdity of some of the administrative techniques that were being provided as a hint. "Mr. Bullock, we're going to show you how to do your work. We want you to go after these people because we think you can make money at it—maybe a hundred and thirty-five million, maybe a hundred and forty-five mil-

lion, and we don't know how much (p. 47) it costs. We frankly don't care. We just think that it's your constitutional duty to go out there and pick those people up, and when you've got all of the pennies, come back and get *Texas Monthly.*" No system? That's right. We don't have a system to get those people, other than voluntary compliance and large ticket items, and that's where the money is, and that's how we're going to pick it up.

Wide discretion? I think the case law, if you'll read it, does say that the Comptroller has discretion in carrying out his job. Rational reason? You decide, you know, if you need to increase Mr. Bullock's budget any more to go out and get that extra money and what it's going to do to operations in the State of Texas. Compelling interest doesn't apply. It's rational basis because they're being treated—it's tangible personal property. This is the same thing as *Texas Monthly* magazine, a piece of paper. You can see it, feel it, pick it up and read it, and that's the only treatment. This is taxable. That's taxable. If it's sold, the same difference. There's no reason for compelling State interest. Nobody is censoring (p. 48) anybody from writing. Everybody has got to pay.

THE COURT: Are we giving somebody that claims it's got some religious faith in there an exemption?

MR. MENDEZ: No, that's up to you, Your Honor. If you think that the religious groups shouldn't be treated that way, then put them under the tax just like everybody else. The newspapers are paying it. Magazines are paying it. Everytime we sell a brief, you're probably paying it. I don't know, but that's the argument that they're making. That's my response to that.

Discriminates against local publishers? Well, it makes sense. The first people you want to go after are the people that are here in Texas—I mean, I think. They should be the people that you want to go after. It doesn't make sense to start our enforcement effort in Maine and work our way down. So, sure, Mr. Shankle was right. One of these days when we get everybody in Texas obeying the law, we can turn our efforts to people that are outside the state and have less contacts and probably less sales, but first we've got to everybody (p. 49) lined up here, and we did pick on these people. They're listed in that, and that does make sense. It's part of the whole rational basis approach.

I don't think, when you get down to it, that there's any reason for giving *Texas Monthly* back its money because everybody else that's in the same shoes is paying it or will pay it, and we'll get them. The argument that I don't want to pay because you aren't paying is not an argument. I don't want to drive 55 until everybody else does is not an argument or is a defense in driving—in a driving violation. In a tax case—and the case law is clear on that—the fact that some other person doesn't pay or that they're in a different class is not a reason for not paying your taxes, and for those reasons, Your Honor, we think that the Comptroller validly imposed taxes upon *Texas Monthly* or required it to collect them.

MR. GEORGE: Very briefly. Your Honor, religious argument—my argument turns back to remedy. What should you do about it? In the Pullman case in the Supreme Court of the United States and every other court that (p. 50) I've ever been aware of that—what you do about it is they say—the Courts say, "Look, tax official,

I can't make anybody pay taxes. I'm a judge. My job is to say you can't enforce the statute as written against people equally situated. I can say you can't collect the taxes from Mr. Jones because you've said Mr. Smith doesn't have to pay. I can't make Mr. Smith pay the taxes. That's the Legislature's job. When the Legislature says, 'Mr. Smith, pay the taxes,' everybody will be square. Until then Mr. Jones doesn't have to pay his taxes." That's the only remedy Courts can give. They can't go out and write statutes. They can't make people pay taxes. That's what needs to be done here. The question of who's a periodical? Who is similarly situated? We know periodicals are similarly situated. There are lots of—there may be lots of questions. Lawsuits may prevail in this, and the Supreme Court affirms it, and we go down the road about who's a periodical, if the Legislature keeps this on the books for the rest of the time. What they choose to do, who knows, and what happens in other cases, who knows. We are a periodical. We proved that, (p. 51) and we proved—and it's no question this is unconstitutional—the remedy is we don't have to pay taxes as long as this is on the books. When it goes off the books, we're back to square one. That's easy.

Briefly his argument about similarly situated. Who testified about soliciting orders in the state? Mr. Lepere said, "I'm familiar with those companies. They solicit orders in this state." "How does it work?" "The order is taken by the guy at the door. The order is sent to *Reader's Digest*, to *Ladies' Home Journal*, which he says he represents." "I know how they do it. They take the order, send it up to the company, and the company sends the

magazine to the subscriber." Mr. Childs said, "That's the way they do it to me. I'm under one of their contracts. Here is a contract. Here is what they do for me." It's in evidence. "They send me orders." The statute says and the Scripto case says, "If you have someone taking orders, it doesn't matter what your contractual relationship with them is, they are in there taking orders," and the rationale for nexus—now, nobody is talking (p. 52) about that. The rationale is that you can't tax people who you don't give any benefit to, and if L. L. Bean doesn't darken the door of the State of Texas and has no—none of the sovereign doesn't give any of the accouterments of being here, they don't use the roads or anything—

THE COURT: They send a mail-order catalog.

MR. GEORGE: —they send a mail-order catalog, you can't tax them. That's the National Bellas Hess case, and the other side is if you have people who are doing things for you using the State of Texas—we've got Girl Scouts and kids and people going door to door. They walked down Mr. Gerhart's street and sold him *Science* magazine, and the purpose was to take an order for that magazine, and the evidence says those orders are taken. They're not sold for resale and then sent to *Science* and *Science* sends the magazine. Those people are getting the benefit of Texas. That's nexus. There's no hard argument. They're similarly situated. Mr. Lepere testified—"How do these companies work?" "Well, they're printed all over the country. They truck their magazines (p. 53) into Texas. They mail them from Texas." "How does *Texas Monthly*?" "It's printed in Nashville, Tennessee. They truck them down here." "How are all these that are printed"—everybody works the same. They solicit ads—

subscriptions the same. They do everything the same. They're similarly situated. That's just—that's not even a real argument.

"Well, we're going to do it some day when we get around to it." That argument—I don't think it's ever worked because the question is when I paid my taxes did you have a system of not doing it? That's what I'm asking for. I'm asking for my taxes back. Mr. Castlebury said, "We knew about it and didn't do it and didn't intend to do it." So did Ms. Wanda Hutcheson. "We didn't intend to do it. We knew about it and and didn't do anything." That's the evidence. We're entitled to a judgment to recover these taxes. That's the judgment we're entitled to. What happens next on this exemption is for some other lawsuit, and you know, if Mr. Bullock and—have a special session, they may take care of it next month, and we won't have to worry about this (p. 54) exemption anymore if the Legislature goes in session, but until they do the Court's job is to decide this lawsuit. Thank you very much.

THE COURT: All right, gentlemen. Thank you for your time and patience with the Court.

MR. MENDEZ: Your Honor, as you know, you're carrying along a plea to the jurisdiction. Do you need any briefing on that or—

THE COURT: On the what?

MR. MENDEZ: A plea to the jurisdiction.

THE COURT: On the Section 8?

MR. MENDEZ: Yeah—no, on paragraph eight of their pleadings.

THE COURT: What was paragraph eight?

MR. MENDEZ: It was their argument that the taxes are gross receipts tax.

THE COURT: Oh, I don't think you're going to have to worry about that part of it, since the way I'm going to rule will take care of it.

(p. 55) MR. MENDEZ: Okay.

THE COURT: Because I'm—frankly, I see no out for the Court but to hold that the provision of 312 is unconstitutional, and I don't think I have to reach a decision on the rest of your—grant relief. That will entitle you to have your taxes.

MR. GEORGE: I'll prepare a judgment. Thank you, Your Honor.

MR. MENDEZ: Thank you, Your Honor.

(p. 56) STATE OF TEXAS)
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COUNTY OF TRAVIS)

I, VICTORIA A. HOLDER, a shorthand reporter and Notary Public for Travis County, Texas, do hereby certify that the above captioned matter came on for hearing before HONORABLE JOE B. DIBRELL, JR., Judge, in the 345th Judicial District of Travis County, Texas, as hereinafter set out.

I FURTHER CERTIFY that the proceedings of said hearing were reported by me, accurately reduced to typewriting under my supervision and control; and, that the

above and foregoing typewritten pages contain a full and correct transcription of my shorthand notes taken on said occasion.

GIVEN UNDER MY hand and seal of office this, the 25th day of February, 1986.

(p. 57) BRIGHT, FULLER & ASSOCIATES
708 Colorado, Suite 700,
Austin, Texas 78701
(512) 478-6971

/s/ Victoria A. Holder
VICTORIA A. HOLDER
Certified Court Reporter and
Notary Public in Travis County
for the State of Texas

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